

Below is an Opinion of the Court.


ELIZABETH PERRIS
U.S. Bankruptcy Judge

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case No.
CASCADE GRAIN PRODUCTS, LLC,) 09-30508-elp11
Debtor.) MEMORANDUM OPINION RE MOTION FOR
APPROVAL OF SETTLEMENT

Debtor Cascade Grain Products, LLC ("debtor") seeks bankruptcy court approval of its settlement with Berggruen Holdings Ltd. ("Sponsor") and its pre-petition lenders ("Loan Creditors"). The United States Trustee ("UST") and creditor JH Kelly, LLC, Ethanol ("Kelly") object.

Debtor, the Sponsor, and the Loan Creditors have disputes relating to the Sponsor Contingent Equity Support Agreement ("Sponsor Support Agreement") entered into prepetition by debtor, the Sponsor, and the Loan Creditors, as an inducement to get the Loan Creditors to provide debtor with financing. Under the Sponsor Support Agreement, the Sponsor agreed under certain circumstances to make contributions to cover specified

1 shortfalls in debtor's financial ability to build and operate an ethanol
2 plant. The settlement resolves those disputes among the three parties,
3 and helps pave the way for debtor to obtain confirmation of its chapter
4 11¹ plan of reorganization.

5 The proposed settlement requires the Sponsor to pay debtor \$10
6 million, which debtor will direct be paid to the Loan Creditors, reducing
7 the Loan Creditors' secured claims against the estate, which are alleged
8 to be approximately \$124 million. The Loan Creditors will in return
9 commit to support and vote in favor of debtor's proposed chapter 11 plan.
10 Debtor and the Sponsor will release all other parties to the Sponsor
11 Support Agreement from any claims relating to that agreement, and the
12 Loan Creditors will release the Sponsor from any claims relating to that
13 agreement. The Loan Creditors will not release debtor from any claims
14 under the financing documents related to the loans they made, except that
15 they will credit the \$10 million payment from the Sponsor against amounts
16 debtor owes to the Loan Creditors.

17 Fed. R. Bankr. P. 9019(a) provides that the court may approve a
18 settlement or compromise on motion by the trustee (or the debtor in
19 possession acting as trustee). Debtor, as the party proposing the
20 compromise, has the burden to show that the compromise is fair and
21 equitable and should be approved. In re A&C Properties, 784 F.2d 1377,
22 1381 (9th Cir. 1986). In considering whether to approve a compromise,
23 the court must consider:

24
25 ¹ Unless otherwise indicated, all chapter, section, and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the
Federal Rules of Bankruptcy Procedure.

1 “(a) The probability of success in the litigation; (b) the
2 difficulties, if any, to be encountered in the matter of collection;
3 (c) the complexity of the litigation involved, and the expense,
4 inconvenience and delay necessarily attending it; and (d) the
5 paramount interest of the creditors and a proper deference to their
6 reasonable views in the premises.”

7 In re Woodson, 839 F.2d 610, 620 (quoting A&C Properties, 784 F.2d at
8 1381). “When assessing a compromise, courts need not rule upon disputed
9 facts and questions of law, but rather only canvass the issues. A mini
10 trial on the merits is not required.” In re Schmitt, 215 B.R. 417, 423
11 (9th Cir. BAP 1997)(citations omitted).

12 1. UST’s Objections

13 The UST raises three objections to the settlement.

14 (a) First, he argues that notice of the settlement was inadequate,
15 because it was not served on all creditors as required by Fed. R. Bankr.
16 P. 2002(a)(3). That rule requires 20 days notice to all creditors, as
17 well as to other parties.

18 Debtor did not serve the notice on all creditors, but served it on
19 the UST, Kelly, the Loan Creditors, the creditors requesting special
20 notice, and the Sponsor. Debtor has attempted to remedy this defect by
21 obtaining an order shortening time to 10 days, serving the notice on all
22 creditors and giving a 10-day objection period, with the opportunity for
23 a hearing if any creditors who did not get the original notice object
24 within the 10 days.

25 The parties who have been active in this case got more than 20 days’
26 notice of the hearing on the motion to settle. The procedure debtor
27 adopted to get notice to all creditors gives 10 days for any previously
28 un-noticed creditor to object before any order approving the settlement

1 would be entered. None of those previously un-noticed parties have
2 objected within the 10 days, nor has any of them sought additional time
3 in which to object. I conclude that debtor's notice of the settlement
4 was adequate.

5 (b) Second, the UST argues that the releases included in the
6 settlement agreement are ambiguous, and possibly not reciprocal. There
7 are two problems.

8 The language in the definition of "Released Claims" in Section 2.1
9 of the agreement is ambiguous. It first defines released claims as
10 claims, "whether or not related to any of the agreements referenced in
11 the recitals [which includes the Sponsor Support Agreement]," but then in
12 the same sentence seems to limit "released claims" to those "arising out
13 of, related to or pertaining to the Sponsor Support Agreement." The
14 settling parties agree that "released claims" are claims relating to the
15 Sponsor Support Agreement only. Debtor has indicated that it will
16 clarify the language in the agreement to make that intent clear. The
17 agreement approved by the court will need to remedy the ambiguity by
18 limiting the released claims to only claims related to the Sponsor
19 Support Agreement.

20 The second problem is that there is a typographical error in Section
21 2.2, titled "Release by Sponsor." The text of the section says that
22 "Borrower" releases claims. Debtor acknowledges that this is a
23 typographical error. The text should say that "Sponsor" releases claims.
24 Debtor will make that change to the agreement.

25 The term "Borrower" is used again in section 2.3, titled "Release by
26 Debtor." "Borrower" is nowhere defined in this agreement. Debtor says

1 the term means "debtor," and that the agreement will be changed either to
2 say that "debtor" releases the claims, or to define "Borrower" as debtor.
3 That change will remedy the problem.

4 (c) The UST objects to Article IV of the settlement agreement,
5 which is an agreement between the Loan Creditors and the Sponsor about
6 what happens if debtor's chapter 11 plan is not confirmed. It provides
7 that, if there is a chapter 7 liquidation or § 363 sale, and if the court
8 allows the Loan Creditors to credit bid, the Sponsor may, upon payment of
9 \$3 million plus an amount sufficient to fund operations for six months
10 into an escrow account, require the Loan Creditors to make the credit bid
11 on the Sponsor's behalf. If the credit bid is successful, the Loan
12 Creditors and Sponsor agree that the assets of debtor will be contributed
13 to a special purpose entity that will be owned 80.1 percent by the
14 Sponsor and 19.9 percent by the Loan Creditors.

15 The UST argues that this provision is an attempt to circumvent the
16 sale requirements of the Bankruptcy Code.

17 I do not think this provision is an attempt to circumvent the sale
18 requirements of the Code, in that the agreement is contingent on the
19 court allowing a § 363 sale and, if there is such a sale, on the Loan
20 Creditors being allowed to credit bid and the credit bid being
21 successful. The parties agreed in open court that any sale would be
22 subject to the requirements of § 363, including court approval.

23 This portion of the settlement agreement is actually an agreement
24 between the Loan Creditors and the Sponsor, and does not involve debtor.
25 Although I do not see this provision as circumventing the Code's sale
26 provisions, I am not willing to enter an order approving what is

1 essentially a side agreement between non-debtor parties. Therefore, the
2 order approving this settlement agreement shall make clear that my
3 approval does not extend to Article IV of the agreement.

4 2. Kelly Objections

5 Kelly has a number of objections. Most of those objections flow
6 from its argument that the settlement is based on the faulty premise that
7 the Loan Creditors have a security interest in the payments the Sponsor
8 is obligated to make under the Sponsor Support Agreement. The settling
9 parties acknowledge that the settlement is based on their view that the
10 Loan Creditors having a security interest in debtor's assets, including
11 the Sponsor Support Claims and proceeds of any Sponsor Support Claims.
12 The crucial question then is whether the Loan Creditors actually have
13 that security interest.

14 (a) Loan Creditors' Security Interest in Sponsor Support Agreement

15 Debtor argues that the Loan Creditors have a first priority security
16 interest in all of debtor's assets, including its accounts, inventory,
17 accounts receivable and general intangibles, and the proceeds of those
18 assets, and that claims and recoveries under the Sponsor Support
19 Agreement are general intangibles.

20 The Loan Creditors provided financing under a Credit Agreement and
21 an Assignment and Security Agreement. Section 2.01 of the Assignment and
22 Security Agreement provides that the Loan Creditors have a security
23 interest in debtor's "estate, right, title and interest in, to and under
24 all assets of [debtor], whether now owned or hereafter existing or
25 acquired," including a long list of types of collateral. Assignment and
26 Security Agreement at Section 2.01 (emphasis supplied). The list

1 includes a number of named agreements as well as inventory, accounts,
2 contract rights, and "all general intangibles." § 2.01(a), (f), (g). It
3 also includes the proceeds of all the assets. § 2.01(l).

4 Kelly points out that the Sponsor Support Agreement is not included
5 in the list of contracts, agreements, and documents in which debtor
6 granted a security interest, indicating that the parties did not intend
7 to include rights under the Sponsor Support Agreement in the security
8 interest. The Loan Creditors explain that it is customary for project
9 financing transactions such as this one to list certain key Project
10 Documents in the security document. But the Sponsor Support Agreement is
11 not a Project Document, it is a financing document, and so it is not
12 specifically listed.

13 This explanation is logical in the context of the security
14 agreement. The contracts listed in Section 2.01(a) of the Assignment and
15 Security Agreement appear to be project documents, not financing
16 documents. There is no evidence to the contrary. Therefore, exclusion
17 of the Sponsor Support Agreement from the list of documents in the
18 Assignment and Security Agreement does not evidence an intention to carve
19 out the Sponsor Security Agreement from "all assets" of debtor, which are
20 subject to the security interest, nor exclude that agreement from the
21 general intangibles that are specifically included.

22 Kelly also says that the Sponsor Support Agreement is not included
23 in the list of documents that defines the term "Project Documents" in the
24 Credit Agreement between debtor and the Loan Creditors. That omission is
25 explained in the same way its omission is explained in the Assignment and
26 Security Agreement; the Sponsor Support Agreement is a financing

1 document, not a project document.

2 Kelly next argues that payments under the Sponsor Support Agreement
3 are not part of the Loan Creditors' security, because those payments are
4 by agreement earmarked for a particular use.

5 The Sponsor Support Agreement obligates the Sponsor to make certain
6 contributions on the occurrence of certain funding deficiencies by
7 debtor. Those proceeds are required to be deposited into specified
8 accounts and applied by debtor "solely" for the payment of specified
9 costs. Sponsor Support Agreement at § 2.03(b) (Project Completion
10 Deficiencies), § 4.04(b) (Soil Stabilization Deficiencies), and § 5.03(b)
11 (Contingency Deficiencies). Kelly argues that this earmarking shows that
12 the Loan Creditors do not have a security interest in the contributions,
13 because those contributions must be used for the specified purpose.

14 Kelly fails to note, however, that the Assignment and Security
15 Agreement allows the Loan Creditors to cause all pledged revenue and
16 moneys "to be paid and/or delivered directly to it" upon a "Security
17 Event of Default." Assignment and Security Agreement at § 6.01(b). A
18 "Security Event of Default" is defined with reference to the Credit
19 Agreement. Id. at p.3. The Credit Agreement defines "Events of Default"
20 to include default by any "Loan Party"² of any obligations under Sections
21 2.02(b) or 3.02 of the Sponsor Support Agreement. Credit Agreement at
22 § 8.01(c). The Sponsor is obligated under section 2.02(b) to make
23 contribution if there is a deficiency in project completion funding, and

24
25 ² "Loan Party" is defined as "the Borrower, the Pledgor, and any
26 Affiliates thereof that are party to any Financing Document." Credit
Agreement at 29. "Financing Documents" includes the Sponsor Support
Agreement. Id. at 22.

1 under section 3.02 to make contribution if there is what is termed an
2 Oregon Loan Deficiency. Thus, the Assignment and Security Agreement,
3 which was executed at the same time as the Sponsor Support Agreement,
4 provides for direct payment to the Loan Creditors in the event of certain
5 defaults.

6 The Loan Creditors also point out that, under the Accounts
7 Agreement, the Collateral Agent for the Loan Creditors may upon certain
8 defaults suspend the rights of debtor to withdraw any funds from the
9 Project Account without the consent of the Collateral Agent, and may
10 collect all funds in which debtor has an interest. Accounts Agreement at
11 § 17.01. The Notice of Suspension that triggers this restriction was
12 given to debtor in December 2008.

13 These provisions support rather than defeat a conclusion that the
14 parties intended the Loan Creditors to have a security interest in the
15 proceeds of the Sponsor Support Agreement.

16 There is no dispute that the Loan Creditors filed a UCC financing
17 statement with the State of Oregon, showing that they hold a security
18 interest in all assets of debtor. I conclude, based on the agreements in
19 evidence, that the Loan Creditors have a security interest in debtor's
20 rights under the Sponsor Support Agreement. Kelly's argument to the
21 contrary fails.

22 (b) Consideration for Settlement Agreement

23 Next, Kelly argues that debtor receives no consideration under the
24 Settlement Agreement, arguing that the only possible benefits debtor
25 could gain are saved litigation costs and the Loan Creditors' commitment
26 to vote in favor of the chapter 11 plan. It claims that debtor is

1 totally abandoning millions of dollars of claims against the Sponsor and
2 getting very little, if anything, in return.

3 The agreement provides that the Sponsor will pay debtor \$10 million,
4 which debtor will in turn direct to be paid for the benefit of the Loan
5 Creditors. In return, the Loan Creditors will credit the \$10 million to
6 what debtor owes, and support the plan. Settlement Agreement at §§ 1.1,
7 2.4, 3.2. According to the Loan Creditors, the plan provides for
8 satisfaction of the Loan Creditors' \$124 million secured claim by payment
9 of \$3 million. In addition, the agreement helps debtor's balance sheet
10 and facilitates new funding from the Sponsor. It also resolves the
11 disputes between debtor and the Sponsor.

12 There is consideration for the settlement agreement. Although the
13 settlement primarily affects the Loan Creditors and the Sponsor, debtor
14 gets payment on its debt to the Loan Creditors, who have a security
15 interest in all of debtor's assets, plus their support of the plan, which
16 would satisfy the \$124 million debt to the Loan Creditors for \$3 million,
17 plus the \$10 million the Loan Creditors will receive from the Sponsor's
18 settlement payment.

19 (c) Legal Standard for Approval of Settlement

20 Debtor urges approval of the settlement, applying the four-factor
21 test set out in Woodson for consideration of settlements under Fed. R.
22 Civ. P. 9019. Kelly argues that debtor's Rule 9019 analysis
23 misrepresents and misapplies the test to be applied to approval of
24 settlements in the context of a plan of reorganization. It argues that
25 the question is whether the settlement is fair and equitable, an analysis
26 that is "wholly independent from, and supreme to, the secondary" four-

1 factor Woodson test. JH Kelly Objection to Debtor's Motion for Approval
2 of Settlement at 5. Relying on In re Iridium Operating LLC, 478 F.3d 452
3 (2d Cir. 2007), it urges this court to focus on whether the settlement
4 conforms to the absolute priority rule rather than whether it satisfies
5 the four-factor Woodson test.

6 Kelly is wrong about the test. First, this is not approval of a
7 settlement in the context of approving a plan of reorganization. If it
8 were, the absolute priority rule would be implicated in considering the
9 plan, not the settlement agreement.

10 Second, Woodson did not say that the four-factor test is separate
11 and apart from the "fair and equitable" test. The Ninth Circuit said:

12 The court may approve a compromise only if it is 'fair and
13 equitable.' Moreover, in passing on the proposed compromise, the
court must consider:

14 '(a) The probability of success in the litigation; (b) the
15 difficulties, if any, to be encountered in the matter of
collection; (c) the complexity of the litigation involved, and
16 the expense, inconvenience and delay necessarily attending it;
(d) the paramount interest of the creditors and a proper
17 deference to their reasonable views in the premises.'

18 839 F.2d at 620 (quoting A&C Properties, 784 F.2d at 1381). Kelly reads
19 the court's "moreover" language as imposing a separate, independent test
20 in addition to the question of whether the settlement is fair and
21 equitable. But the Woodson test comes from A&C Properties, and it is
22 clear from that case that the four factors are used to determine whether
23 the compromise is fair and equitable. In A&C Properties, the court said:

24 It is clear that there must be more than a mere good faith
25 negotiation of a settlement by the trustee in order for the
bankruptcy court to affirm a compromise agreement. The court must
26 also find that the compromise is fair and equitable.

1 In determining the fairness, reasonableness and adequacy of a
2 proposed settlement agreement, the court must consider [the four
3 factors].

4 784 F.2d at 1381 (citations omitted). The four factors are to be
5 considered in determining whether the compromise is fair and equitable,
6 not independently of the fair and equitable requirement.

7 The case on which Kelly relies, Iridium, involved a request for
8 court approval of a pre-plan settlement that involved the distribution of
9 estate assets to creditors. The Second Circuit concluded that, where a
10 settlement is not a part of a plan of reorganization, the absolute
11 priority rule is not necessarily implicated, as it would be if the
12 settlement were part of a reorganization plan. When the settlement is
13 presented apart from the plan, the court recognized a heightened risk
14 that the parties to the settlement would collude to favor junior classes
15 of creditors over senior classes of creditors. In order to address that
16 risk, the court said:

17 In the Chapter 11 context, whether a settlement's distribution
18 plan complies with the Bankruptcy Code's priority scheme will often
19 be the dispositive factor. However, where the remaining factors
20 weigh heavily in favor of approving a settlement, the bankruptcy
21 court, in its discretion, could endorse a settlement that does not
22 comply in some minor respects with the priority rule if the parties
23 to the settlement justify, and the reviewing court clearly
24 articulates the reasons for approving, a settlement that deviates
25 from the priority rule.

26 478 F.3d at 464-65.

 The Ninth Circuit has not adopted the Second Circuit's rule that
requires compliance with the absolute priority rule as the paramount
concern. In this circuit, we apply the test in Woodson to determine
whether a settlement is fair and equitable. The fourth factor of that
test, the interests of creditors, takes into account the treatment

1 creditors will receive if the settlement is approved, including if
2 applicable whether any distribution would violate the priority rules of
3 the Code.

4 In any event, this settlement does not discriminate unfairly or
5 violate the absolute priority rule. Kelly's argument that this agreement
6 allows the Sponsor to "artificially create a wholly separate 'secured'
7 class for the Loan Creditors" can only be based on Kelly's argument,
8 which I have rejected, that the Loan Creditors are not secured. Their
9 claims are secured, and therefore there is no artificial class of secured
10 creditors being created here. Kelly does not explain how its asserted
11 first priority lien on the real property and improvements will be hurt by
12 this settlement, which will result in at least a partial satisfaction of
13 the Loan Creditors' secured claims.

14 Kelly argues that the settlement violates the absolute priority
15 rule, because the Sponsor is buying an 81% interest in the reorganized
16 debtor, thereby retaining an equity interest in debtor ahead of Kelly,
17 who is undersecured.

18 This settlement does not result in the Sponsor obtaining any
19 interest in the debtor. The Sponsor is agreeing to a process to be
20 applied in case the plan fails and there is a § 363 sale.

21 Kelly also argues that this is an invalid *sub rosa* plan, which
22 circumvents the plan confirmation process. This settlement does not
23 circumvent the plan process. It requires the Loan Creditors to vote in
24 favor of the plan that has already been proposed. This settlement, if
25 approved, will go into effect whether or not the plan is confirmed. Plan
26 confirmation issues should and will be dealt with during the plan

1 confirmation process. The focus here is on whether to approve the
2 settlement. Although the settlement is critical to plan confirmation, in
3 that debtor will not be able to go forward with its plan if this
4 settlement is not approved, the settlement is not in reality the plan.
5 It is possible that the plan will not be confirmed, even if the
6 settlement is approved and implemented.

7 Kelly also asserts that the settlement results in debtor waiving its
8 preference claims. As discussed above, the parties have clarified, and
9 will assure that the settlement agreement reflects, that the only claims
10 being released are those relating to the Sponsor Support Agreement.

11 (d) Application of Woodson Factors

12 (1) Probability of success in the litigation

13 Kelly argues that debtor gets nothing from the settlement but gives
14 up potential claims. It does not discuss debtor's probability of success
15 in any litigation against the Sponsor under the Sponsor Support
16 Agreement, but merely says that there must be some probability of
17 success.

18 Debtor explains that the Sponsor Support Agreement is complex and
19 subject to varying interpretations. The parties dispute the extent of
20 the Sponsor's obligation to make payments, including whether certain
21 events triggering that obligation have occurred. Debtor's CEO testified
22 that the Sponsor has indicated that it has defenses that it would assert
23 to any claims debtor might make. In addition, if debtor were to prevail
24 in its claims against the Sponsor, the proceeds of that litigation would
25 flow to the Loan Creditors, not to the estate for the benefit of
26 unsecured creditors. Although the likelihood of success of litigation

1 between debtor and the Sponsor is unclear, the Sponsor Support Agreement
2 is complex, litigation would undoubtedly be expensive, and any recovery
3 would benefit the Loan Creditors, not the estate.

4 (2) Difficulties in collection

5 No difficulties in collection are identified. Kelly does not
6 dispute that there would be no problems with collection.

7 (3) Complexity of the litigation and expense, inconvenience,
8 and delay

9 Kelly says that debtor, because it is controlled by the Sponsor, has
10 not undertaken any analysis about the expense, inconvenience, or delay
11 that would be involved in litigating against the Sponsor. Debtor and the
12 Loan Creditors point out that this would be costly, multi-party
13 litigation, with an unknown outcome. I agree that the litigation would
14 be complex, time-consuming, and expensive.

15 (4) Interests of creditors

16 Kelly argues that the Settlement Agreement completely disregards the
17 views of other creditors, violates the Code's priority rules, diverts
18 significant value away from the estate into the hands of second-priority,
19 if not wholly unsecured, creditors, and circumvents the plan confirmation
20 process. Debtor argues that the interests of creditors are being
21 protected by resolving these disputes among debtor, the Loan Creditors,
22 and the Sponsor, resulting in a substantial payment from the Sponsor that
23 will reduce the amount of the claim of the Loan Creditors and free up
24 resources for resuming operations.

25 Kelly's argument is based on its erroneous view of the secured
26 status of the Loan Creditors and the consequences of settling or not

1 settling the claims relating to the Sponsor Support Agreement. Because
2 of Kelly's erroneous view of the secured status of the Loan Creditors and
3 of the consequences of settlement, including the fact that it is not in
4 fact the plan of reorganization, its arguments about eviscerating the
5 priorities set by the Bankruptcy Code and circumventing the plan process
6 fail.

7 This settlement will resolve potentially costly litigation with the
8 Sponsor and the Loan Creditors, and will pave the way to provide debtor
9 with relief from a \$124 million obligation to the Loan Creditors. It
10 will also pave the way to reorganization and the eventual restarting of
11 production of ethanol. This was a negotiation among parties with varying
12 interests. Debtor has demonstrated that the settlement will benefit the
13 estate by eliminating potential litigation and a large secured (and
14 likely large undersecured) debt. Debtor has not disregarded the
15 interests of Kelly in this settlement, but has found a resolution with
16 the Loan Creditors and Sponsor that will benefit everyone if the
17 settlement is approved and the plan, which is contingent on the
18 settlement, can be approved.

19 CONCLUSION

20 I conclude that debtor has demonstrated that this settlement is fair
21 and equitable. I will approve it, subject to the few changes I discussed
22 above. Mr. Pahl should submit the order.